89- 1583

No. 89-.....

Supreme Court, U.S.
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1989

IN RE: EDWARD MIKE DAVIS,
d/b/a TIGER OIL COMPANY, and
TIGER DRILLING CO., INC.,

Debtors.

RHETT G. CAMPBELL, TRUSTEE,
*Petitioner,*

*V.*

UNITED STATES OF AMERICA,
*Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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April 9, 1990

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## QUESTIONS PRESENTED

1. Do the mandatory disallowance provisions of 11 U.S.C. § 502(d) apply to disallow the government's claims for additional taxes, penalties, and interest against the Debtors in a bankruptcy proceeding, where the Internal Revenue Service has refused to pay to the Debtors tax refunds to which they have been entitled since August 1982 pursuant to a Final Judgment entered by a United States Bankruptcy Court?

2. May a putative creditor, in this case the Internal Revenue Service, assert as a "claim" against a Debtor in bankruptcy an alleged tax deficiency that previously has been determined not to exist in a Final Judgment of a United States Bankruptcy Court?

3. Does the law of judgments apply with respect to a Final Judgment entered by a United States Bankruptcy Court?

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**IN THE SUPREME COURT OF THE UNITED STATES**

**OCTOBER TERM, 1989**

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**IN RE: EDWARD MIKE DAVIS,**
**d/b/a TIGER OIL COMPANY, and**
**TIGER DRILLING CO., INC.,**

**Debtors.**

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**RHETT G. CAMPBELL, TRUSTEE,**

*Petitioner,*

**V.**

**UNITED STATES OF AMERICA,**

*Respondent.*

---

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT**

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Petitioner Rhett G. Campbell, Trustee respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on January 22, 1990.

## OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit is reported at 889 F.2d 658, and is set forth in the Appendix hereto, at p. A1-A23.

The judgment of the United States District Court for the Southern District of Texas, Houston Division (Hughes, J.), was not accompanied by a written opinion and is not reported. The district court's oral findings of fact and conclusions of law, and the Final Judgment and Amended Final Judgment entered by the district court, are set forth in the Appendix hereto, at p. B1-B18.

## JURISDICTION

The opinion below, and the original judgment of the Court of Appeals, were entered on December 8, 1989. The Petitioner timely filed a Petition for Rehearing, which was denied on January 10,

1990. The final judgment of the Court of Appeals, issued as and for the mandate, was entered on January 22, 1990.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTE INVOLVED

This case concerns the construction of 11 U.S.C. § 502(d), which provides:

> Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section

522(i), 542, 543, 550, or 553 of this title.

## STATEMENT OF THE CASE

1. This case is an action against the Internal Revenue Service ("IRS") to secure refunds for overpayments of taxes. The refunds are owed to Debtors Edward Mike Davis d/b/a Tiger Oil Company, and Tiger Drilling Co., Inc. (the "Debtors"). Pursuant to a Plan of Reorganization approved by the bankruptcy court in the Debtors' consolidated bankruptcy proceedings, the Debtors assigned their rights to the tax refunds to the trustee of a Creditors Trust. The Petitioner, Rhett G. Campbell, Trustee, is the successor trustee of that Creditors Trust, and brought this action to secure the refunds due. The jurisdiction of the bankruptcy court was invoked pursuant to former 28 U.S.C. § 1471(c).

The Debtors' underlying Chapter 11 proceedings were commenced in the

bankruptcy court for the Southern District of Texas on June 24, 1980, and were subsequently consolidated. In June 1981, the IRS issued to the Debtors a notice of deficiency asserting deficiencies in income taxes and penalties totaling in excess of $5 million. On August 18, 1981, the Debtors filed with the bankruptcy court a proof of claim on behalf of the IRS, and initiated an adversary proceeding to resolve their liability for the asserted tax deficiencies. The adversary proceeding was thereafter transferred to the bankruptcy court for the Western District of Texas in San Antonio, and was later expanded to cover an additional $1.2 million disputed gift tax deficiency which was asserted by the IRS in a notice of deficiency dated July 9, 1982 (hereinafter "the San Antonio litigation").

The San Antonio litigation was decided adversely to the IRS in 1982. Specifi-

cally, on June 29, 1982, the San Antonio bankruptcy court entered Findings of Fact and Conclusions of Law, based upon which it held that (except in very small part) the Debtors were not liable to the IRS for any of the taxes or penalties at issue in that litigation. A Final Judgment consistent with these findings and conclusions was entered in the San Antonio litigation on August 16, 1982. Thus, as of that date, the tax deficiencies asserted against the Debtors in the San Antonio litigation were conclusively determined by the bankruptcy court not to exist.

The IRS appealed the Final Judgment in the San Antonio litigation to the United States District Court for the Western District of Texas. The bankruptcy court's judgment was thereafter affirmed by the district court in all respects on November 9, 1987. The government then filed a notice of appeal to the United States

Court of Appeals for the Fifth Circuit, but on March 10, 1988, the IRS stipulated to a dismissal of its appeal in the San Antonio litigation.[1/]

In the interim, the Debtors' Plan of Reorganization was proposed and approved by the Houston bankruptcy court on June 17, 1983. The Plan of Reorganization established a Creditors Trust, of which the Petitioner became, and remains, the successor trustee. The trustee of the Creditors Trust was assigned certain of the Debtors' assets, including the tax refunds made the basis of the instant litigation, and was charged with the duty of eventually making distributions to the unsecured creditors of the Debtors who were the beneficiaries of the Creditors

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[1/] At no time did the government request--from either the district court or the Court of Appeals--a stay of the Final Judgment entered in the San Antonio litigation.

Trust. The Order confirming the Plan of Reorganization recognized that the San Antonio litigation had not been finally resolved, and provided that there was to be no distribution of assets to the unsecured creditors until that litigation (including any appeal or retrial) had been resolved, or until an Order permitting distributions was entered by the bankruptcy court. The IRS was thereby fully protected under the Plan of Reorganization in the event that its pending appeal of the San Antonio litigation proved successful. Nevertheless, the IRS refused to turn over, to either the Debtors or the Petitioner, refunds of various tax overpayments that concededly were due to the Debtors.[2/] Instead, the IRS simply

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2/ The IRS conceded, both at trial and in the Court of Appeals, that the refunds claimed by the Petitioner were due as alleged. Indeed, the parties stipulated to the factual basis for the Petitioner's claims.

retained those refunds as a form of security for the claims it had raised, and lost, in the San Antonio litigation.3/

Within this context, the Petitioner commenced the instant action on June 1, 1984. Specifically, the Petitioner filed a turnover action under 11 U.S.C. § 542(a), seeking, inter alia, to compel the IRS to pay the tax refunds owed to the Debtors, plus interest. As originally brought, the Petitioner's action sought from the IRS a net amount due after taking into account the effect of various additional taxes (apart from those at issue in the San Antonio litigation) alleged to be owed by the Debtors. Later, however, the Petitioner determined to invoke against the IRS the mandatory

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3/ As noted above, the Debtors' Plan of Reorganization was approved by the Houston bankruptcy court over the objections of the IRS. Nevertheless, the IRS did not appeal the Order confirming the Plan of Reorganization.

disallowance provisions of 11 U.S.C. § 502(d). Thus, the Petitioner ultimately recognized no right of the IRS to offset any amounts against the refunds owed to the Debtors, because the government's longstanding refusal to turn over those refunds subjected any claims for additional taxes, penalties, or interest to mandatory disallowance under section 502(d). Accordingly, the Petitioner sought to be awarded the full amount of the refunds claimed, with interest, and with no reduction for any additional taxes, penalties, or interest alleged to be owed to the IRS by the Debtors.[4/]

2. The action was initially presided over in the bankruptcy court by a succession of Judges. Trial of the case

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[4/] The Petitioner also objected to any offset against the refunds due because the IRS had raised in the proceedings below no claim, by way of counterclaim or otherwise, for any additional taxes alleged to be owed by the Debtors.

was continued on several occasions, but the case was ordered to be made trial ready, which the parties did. In September 1987, reference of the action was withdrawn by General Order of the district court. The case was then assigned to the docket of the Honorable Lynn Hughes, before whom it was tried in a bench trial held on March 15, 1988. By this time, the IRS had (on March 10, 1988) stipulated to the dismissal of its appeal in the San Antonio litigation. Accordingly, the IRS for the first time averred any willingness to turn over to the Petitioner the tax refunds owed to the Debtors, net of its claims for additional taxes.

The district court accepted the Petitioner's stipulated claims for refunds, and awarded the full amount requested, with interest. The district court then reduced this amount by the principal amounts of the additional taxes claimed by

the IRS to be owed by the Debtors. However, repeatedly noting the inequitable nature of the IRS' actions in delaying payment of the refunds at issue, the district court disallowed any penalties or interest on the IRS' claims for additional taxes. Appendix, p. B7-B18. The end result was an award to the Petitioner of $1,397,568.00, to which the district court added $15,000.00 in attorneys' fees.5/

3. Both parties appealed from the district court's Amended Final Judgment. The Court of Appeals did not specifically address the Petitioner's cross-appeal, which argued that the IRS' claims for additional taxes should have been disallowed in full under section 502(d). On the government's appeal, the Court of Appeals reversed the district court's

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5/ The amounts of penalties and interest disallowed by the district court are alleged by the IRS to be approximately $1.1 million. Appendix, p. A12.

partial disallowance of the IRS' claims, and remanded the case with apparent instructions to reinstate the disallowed claims for penalties and interest. In so doing, the Court of Appeals held that the disallowance provisions of section 502(d) did not apply on the facts of this case. Appendix, p. A13.

The Court of Appeals first noted that the right of setoff is generally preserved and found in the Bankruptcy Code under 11 U.S.C. § 553(a). Without explanation, the Court of Appeals then stated that "[i]n this scenario, the IRS' right to setoff derives from Section 6402(a) of the Internal Revenue Service Code of 1986, which provides that generally a party is only entitled to a tax refund of the amount which exceeds any outstanding tax liabilities." Appendix, p. A15-A16 (citations omitted). Thus, the appellate court effectively ruled that the tax

deficiencies originally at issue in the San Antonio litigation continued to be available to the government for purposes of setoff under section 553(a), even though they had been conclusively determined not to exist in the San Antonio bankruptcy court's August 1982 Final Judgment.

Turning then to an analysis of section 502(d), the Court of Appeals observed that the statute's disallowance provisions are not intended to be punitive in nature, but instead are "intended to have the coercive effect of insuring compliance with judicial orders." Appendix, p. A17. Hence, before the statute's disallowance mechanism is triggered, a creditor is entitled to "a reasonable time in which to turn over amounts adjudicated to belong to the bankruptcy estate." Appendix, p. A18 (footnote omitted). Applying these principles to the facts of this case, the

Court of Appeals measured the time between the resolution of the appeal in the San Antonio litigation (March 10, 1988), and the trial date of the Petitioner's suit for tax refunds (March 15, 1988). The resulting five-day period was found "not [to] afford the IRS a reasonable time [within which to turn over to the Petitioner the refunds due to the Debtors]." Appendix, p. A18. Accordingly, section 502(d) was held not to apply in this case, and the district court's partial disallowance of the IRS' claims for additional taxes was reversed.

## REASONS FOR GRANTING THE WRIT

### I.

### THE FIFTH CIRCUIT'S DECISION CONFLICTS WITH THE LAW OF JUDGMENTS GENERALLY, AND WITH DECISIONS OF SEVERAL OF THE COURTS OF APPEALS.

The provisions of section 502(d) facially mandate the disallowance of any claim of a creditor who has failed to pay

any amount, or to turn over any property, for which the creditor is liable to a bankruptcy estate. Despite the statute's seemingly obligatory wording, however, its disallowance provisions have long been construed not to be absolute. Nor, as the Court of Appeals correctly observed, are the disallowance provisions intended to be punitive in nature. They do not, for example, require disallowance of a creditor's claim in bankruptcy for the creditor's mere receipt of a preference or fraudulent transfer--the creditor is entitled to litigate the validity of the challenged transaction without penalty. See Keppel v. Tiffin Savings Bank, 197 U.S. 356 (1905) (construing the predecessor to section 502(d), i.e., section 57g of the Bankruptcy Act of 1898). At the same time, the disallowance provisions are intended to be coercive, and disallowance of a creditor's claim is requir-

ed if the creditor has refused, within a reasonable time, to disgorge any property to which it has been found not entitled. Thus, citing as authority this Court's decision in Keppel, the Fifth Circuit recognized that section 502(d) is "designed to be triggered after a creditor has been afforded a reasonable time in which to turn over amounts adjudicated to belong to the bankruptcy estate." Appendix, p. A17-A18.

It is undisputed that, as of the date of trial on the Petitioner's claims, the IRS had not turned over to the Petitioner the tax refunds concededly due to the Debtors. The determinative question, then, is when the "reasonable time" within which the IRS was required to turn over the Debtors' tax refunds began to run.[6/] The

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[6/] The Court of Appeals succinctly framed the issue as follows: "whether the IRS must refund the amount owed [to avoid the disallowance provisions of section 502(d),] or be able to wait until the final determination in the San Antonio litigation." Appendix, p. A16.

Court of Appeals held that the date of final adjudication of a creditor's liability *is only after all appeals are exhausted*, and not the date of initial adjudication thereof. Indeed, the essential holding of the decision below is that a "creditor is . . . entitled to a reasonable time after the final determination [of liability] until Section 502(d) is kicked into effect." Appendix, p. A19 (emphasis added). Applying this rule to the facts of the case, the Court of Appeals measured the relevant time as commencing only as of March 15, 1988, i.e., the date that the IRS stipulated to dismissal of its appeal in the San Antonio litigation. Thus, for purposes of its analysis under section 502(d), the appellate court simply ignored the August 1982 Final Judgment entered in favor of the Debtors by the San Antonio bankruptcy court.

The rule announced and applied by the Fifth Circuit is completely at odds with the law of judgments. The decision below expressly permits an offending creditor to ignore, with impunity, a Final Judgment issued by a federal court, until a "reasonable time" after that judgment no longer is subject to any further appellate review. But under the law of judgments, a Final Judgment is res judicata as to all matters decided therein, and is entitled to full preclusive effect notwithstanding the pendency of an appeal. Indeed, it is settled as a matter of federal law that the pendency of an appeal does not diminish the res judicata effect of a judgment rendered by a federal court. See, e.g., Erebia v. Chrysler Plastics Products Corp., 891 F.2d 1212, 1215 n.1 (6th Cir. 1989); Blinder, Robinson & Co., Inc. v. S.E.C., 837 F.2d 1099, 1104 n.6 (D.C. Cir.), cert. denied, ___ U.S. ___,

109 S. Ct. 177, 102 L. Ed.2d 146 (1988); Jaffree v. Wallace, 837 F.2d 1461, 1467 (11th Cir. 1988); Eichman v. Fotomat Corp., 759 F.2d 1434, 1439 (9th Cir. 1985); Hunt v. Liberty Lobby, Inc., 707 F.2d 1493, 1497 (D.C. Cir. 1983); Taunton Gardens Co. v. Hills, 557 F.2d 877, 879 n.2 (1st Cir. 1977); Fidelity Standard Life Ins. Co. v. First National Bank & Trust Co. of Vidalia, Georgia, 510 F.2d 272, 273 (5th Cir.), cert. denied, 423 U.S. 864 (1975). See also 18 Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction § 4433 (1981), and cases cited therein.

The decision below is therefore in conflict with the law of judgments generally, and with the many decisions holding that the pendency of an appeal does not alter the res judicata effect of a Final Judgment. The conflict derives from a dramatic departure by the Fifth

Circuit from well settled principles of law, and could not be more complete.7/ It deserves this Court's consideration so that the lower courts may be properly guided in the application of the principles of the law of judgments in the context of bankruptcy proceedings.

II.

THE FIFTH CIRCUIT'S DECISION RAISES IMPORTANT QUESTIONS OF FEDERAL LAW.

Under the analysis advanced by the Fifth Circuit, the law of judgments does not apply to at least some aspects of bankruptcy proceedings. For purposes of

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7/ Indeed, the decision below also conflicts with lower court decisions in which the law of judgments has been recognized and applied in the context of bankruptcy proceedings as a matter of course. See, e.g., Zervas v. Nix (In Re Nix), 92 Bankr. 164, 167 (Bankr. N.D. Tex. 1988); In Re Independent Refining Corp., 65 Bankr. 622, 625 (Bankr. S.D. Tex. 1986); Hotel Corporation of the South v. Rampart 920, Inc., 46 Bankr. 758, 767 n.4 (E.D. La. 1985), aff'd. without opinion, 781 F.2d 901 (5th Cir. 1986).

section 502(d) analysis, Final Judgments rendered by the bankruptcy courts in the context of claims adjudication are meaningless and may be ignored with impunity. Thus, the decision below raises a question as to the applicability of the law of judgments to bankruptcy proceedings. This is an important question of federal law that is deserving of plenary consideration by this Court.

The decision below also raises serious and important questions concerning the future administration of bankruptcy estates, i.e., voting on plans of reorganization.[8/] Under the Fifth Circuit's analysis, the coercive effect of section 502(d) cannot be brought to bear against a creditor until "final determination" of liability to the estate, i.e.,

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8/ Rule 3018, Rules of Bankruptcy Procedure; e.g., In re Coral Petroleum, Inc., 60 Bankr. 377 (Bankr. S.D. Tex. 1986); contra In re Amarex, Inc., 61 Bankr. 301 (W.D. Okla. 1985).

until all avenues of appeal have been exhausted by the creditor. As this case illustrates, the appeals process can easily drag on for years. Yet, until such "final determination," a recalcitrant creditor claiming a right of setoff may simply ignore a bankruptcy court's adjudication of liability to the bankruptcy estate. Moreover, unlike a losing litigant in any other situation, the offending creditor need not bother to obtain (or even seek) a stay of the bankruptcy court's Final Judgment.9/ The result, as this case also illustrates, is that section 502(d) is effectively rendered useless as a coercive device.

More importantly, the effective and efficient administration of bankruptcy estates as a whole will be virtually impossible if the decision below is

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9/ As noted above, the IRS neither obtained, nor sought, a stay of the Final Judgment in the San Antonio litigation.

permitted to stand. Recalcitrant creditors not only will be free to ignore the adjudications of the bankruptcy courts until all avenues of appeal thereof have been exhausted, but also apparently will be permitted to raise as "claims" available for setoff under section 553(a), alleged debts that have been determined not to exist.10/ The result is that major claims adjudication will prove to be endless, and the bankruptcy process in general, and the fair and efficient

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10/ This result is neither logical, nor in conformity with the statutory definition of "claim." The Bankruptcy Code defines "claim" as a "right to payment . . . ." 11 U.S.C. § 101(4). See Mooney Aircraft Corp. v. Foster (Matter of Mooney Aircraft, Inc.), 730 F.2d 367, 375 n.6 (5th Cir. 1984). The IRS had no "right to payment" of the tax liabilities asserted against the Debtors in the San Antonio litigation, because those liabilities were conclusively determined not to exist in the Final Judgment entered therein in August 1982. Nevertheless, the Fifth Circuit inexplicably, and without explanation, permitted the IRS to treat those alleged tax deficiencies as "claims," for purposes of setoff under section 553(a), in the proceedings below.

administration of bankruptcy estates in particular, will suffer accordingly. Thus, the decision below raises important questions of federal law that are deserving of the Court's attention.

## CONCLUSION

For the reasons set forth above, the Petitioner respectfully submits that this petition for a writ of certiorari should be granted.

Respectfully submitted,


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**In the Matter of Edward Mike DAVIS d/b/a Tiger Oil Company, and Tiger Drilling Company, Inc., Debtors.**

**Rhett G. CAMPBELL, Trustee, Appellee Cross-Appellant,**

**v.**

**UNITED STATES of America, Appellant Cross-Appellee.**

**No. 88-2555.**

United States Court of Appeals, Fifth Circuit.

Dec. 8, 1989.

[SUMMARY]

Internal Revenue Service's tax claims were disallowed by the United States District Court for the Southern District of Texas, Lynn N. Hughes, J., for failing to turn over refunds upon request of trustee, and IRS appealed. The Court of Appeals, Garza, Circuit Judge, held that Internal Revenue Service's failure to turn over tax refunds withheld from Chapter 11 debtors within five days of its stipulation to dismissal of appeal of District Court order was not "unreasonable

delay" warranting disallowance of its claims.

Reversed and remanded with directions.

1. **Bankruptcy †2921**

Internal Revenue Service's failure to turn over tax refunds withheld from Chapter 11 debtors within five days of its stipulation to dismissal of appeal of district court order affirming bankruptcy court determination that debtors were not liable for taxes or penalties was not "unreasonable delay," and thus did not justify bankruptcy court's disallowance of remaining IRS claims against Chapter 11 debtor. Bankr. Code, 11 U.S.C.A. §§ 502(d), 553(a).

2. **Bankruptcy †2921**

Bankruptcy Code provision permitting disallowance of claim of entity for failing to turn over property which is recoverable by truscee is designed to assure equality of distribution of assets

of estate, not create penalties for asserting setoff right. Bankr. Code, 11 U.S.C.A. §§ 502(d), 553(a).

3. Bankruptcy †2921

Penalization for meritless appeal cannot be accomplished by using Bankruptcy Code section permitting disallowance of claim of entity for failing to turn over to trustee property which is recoverable; creditor is entitled to reasonable time after final determination until such section is "kicked into effect." Bankr. Code, 11 U.S.C.A. § 502(d).

4. Bankruptcy †2183

Upon reversal of determination of bankruptcy court and district court disallowing IRS claims due to IRS's failure to immediately turn over refunds to Chapter 11 debtors, trustee was no longer prevailing party, and thus, award of attorney fees entered by district court on appeal was required to be reversed.

Bankr. Code, 11 U.S.C.A. § 502(d); 26 U.S.C.A. § 7430.

**5. Bankruptcy †2921**

Purpose behind Bankruptcy Code section requiring disallowance of claim of entity from which property is recoverable for failing to turn over such property is to assure bankruptcy estate that creditor will not be allowed to assert claim without first paying his own debts, but not to penalize creditor before expiration of reasonable time after final determination of liability. Bankr. Code, 11 U.S.C.A. § 502(d).

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[OPINION]

Appeals from the United States District Court for the Southern District of Texas.

Before GARZA, REAVLEY, and POLITZ, Circuit Judges.

GARZA, Circuit Judge:

On June 24, 1980, the debtors, Edward Mike Davis d/b/a Tiger Oil Company and Tiger Drilling Company, Inc., filed petitions for reorganization under Chapter 11 of the Bankruptcy Code. These petitions were later consolidated. In a notice of deficiency mailed to Edward Mike Davis (Davis) on June 12, 1981, the Commissioner of Internal Revenue asserted deficiencies in income taxes and penalties against the debtors, as follows:

| Period Ending | Delinquency Penalty Section 6651(a) | Amount of Taxes |
|---|---|---|
| December 31, 1972 | $2,830 | $56,606 |
| December 31, 1976 | - 0 - | 871,488 |
| December 31, 1977 | 567,000 | 3,780,006 |

On August 18, 1981, the debtors brought an adversary proceeding in the Bankruptcy Court for the Southern District of Texas to resolve their liability for these

taxes.[1/] The adversary proceeding was eventually transferred to the Bankruptcy Court for the Western District of Texas in San Antonio (hereinafter the "San Antonio litigation").

On September 28, 1981, the Internal Revenue Service filed a proof of claim with the Bankruptcy Court for the Southern District of Texas seeking the payment of certain taxes, including those that were the subject of the San Antonio litigation. This claim against the debtors totaled $5,634,475.60.

On February 17, 1983, a second proof of claim was filed by the Internal Revenue Service asserting additional employment taxes in the amount of $39,155.21. The

[1/] The adversary proceeding was later expanded to consider a gift tax deficiency for the quarter ending September 30, 1986, in the amount of $1,231,620, including penalties and interest, which had been asserted in a notice of deficiency mailed by the Commissioner to Davis on July 9, 1982.

Government's September 28, 1981, claim was then supplemented on June 13, 1984, and again on December 18, 1984, adding claims for taxes, penalties and interest totaling $303,095.08. Between September 24, 1981, and June 18, 1984, the Internal Revenue Service also filed various claims for taxes incurred after the petition was filed, later filing amendments thereto, which together sought an additional $476,718.59. The latter claim brought the total amount of taxes, penalties and interest being claimed by the Government to $6,453,444.48.

On June 29, 1982, the San Antonio Bankruptcy Court entered Findings of Fact and Conclusions of Law, based upon which it held that the debtors were not liable for any of the taxes or penalties at issue in the San Antonio litigation, with the exception of approximately $84,000 that the debtors admitted was owed for the year

1972. Final judgment was entered on August 16, 1982. On November 29, 1982, the IRS appealed this judgment to the District Court for the Western District of Texas in San Antonio. On May 27, 1983, while the appeal was pending, the debtors filed a First Amended and Consolidated Plan of Reorganization. This plan proposed the creation of a Creditor's Trust for the purpose of receiving certain cash and property from the bankruptcy estates and disbursing the proceeds realized from those assets and such other assets as may be received by the trustee to certain creditors, including the Internal Revenue Service.

On June 24, 1983, with the District Court in San Antonio still having not yet ruled on the appeal of the San Antonio litigation, the Bankruptcy Court for the Southern District of Texas entered an order confirming the amended plan. With

respect to the San Antonio litigation, this order provided:

> The Trustee shall not make any distributions to Class 4 creditors until the tax litigation has been finally resolved or until a court order has been entered permitting such distribution. This Bankruptcy Court shall retain jurisdiction to determine whether the claim, if any, of the Internal Revenue Service may be subordinated to money borrowed by the trustee for the purposes of protecting, maintaining, preserving or developing the Trust Property.

The plan defined "tax litigation" to include the taxes involved in the San Antonio litigation, and any appeal, remand, retrial or other continuation of such litigation.

In 1984, with the District Court appeal in the San Antonio litigation still

unresolved, the successor trustee of the Creditor's Trust, Rhett G. Campbell, filed an action in the Bankruptcy Court for the Southern District of Texas seeking, *inter alia*, to recover the balance of certain refunds that the debtors had claimed.[2/] Although at that point the trustee sought only the amount of the refunds less a setoff for federal tax liabilities that were admitted to be due later, the trustee also asserted that under 11 U.S.C. § 502(d), all the Governments tax claims should be disallowed because of the IRS's failure to surrender the refunds after entry of the Bankruptcy Court's judgment

[2/] The amount of the refunds sought in this complaint, was $396,736.49 together with statutory interest. This balance, however, did not take into account the taxes involved in the San Antonio litigation. The complaint also sought a declaratory judgment that the Internal Revenue Service was not entitled to continue to retain the refunds, and a permanent injunction preventing the Service from continuing to fail to pay the aforementioned sums.

in the San Antonio litigation, notwithstanding that the latter judgment was on appeal. The turnover action, nonetheless, was repeatedly continued by various judges of the Bankruptcy Court for the Southern District of Texas pending resolution of the appeal in the San Antonio litigation.

The district court appeal in the San Antonio litigation remained unresolved until Judge Edward C. Prado of the San Antonio District Court, on November 9, 1987, entered an order affirming the San Antonio Bankruptcy Court's judgment. Following the entry of judgment by the district court in the San Antonio litigation, the United States, on January 4, 1988, filed a notice of appeal to this Court. On March 10, 1988, however, the Government stipulated to a dismissal of its appeal. Shortly thereafter, representatives of the Internal Revenue Service met with the trustee and attempted to come

to an agreement regarding the amount of refunds to be turned over to the trustee. These negotiations, however, proved unsuccessful and on March 15, 1988, the District Court for the Southern District of Texas (Hon. Lynn N. Hughes) conducted a hearing on the matter.

After receiving evidence and hearing oral argument, the district court disallowed a substantial portion of the United States' remaining tax claims, an amount totaling approximately $1,092,216.19, based on the Internal Revenue Service failure to turn over the refunds upon the request of the trustee.3/ The district court awarded $1,397,568.00 in principal and also awarded the debtors $15,000 in attorneys' fees. The court made this additional award "in order to speedily terminate the litigation," even

3/ The amounts disallowed consisted of interest and penalties on the delinquent taxes.

though the trustee had made no formal application for the fees and had not provided any documentation regarding the legal costs incurred by him. On March 25, 1988, the district court entered an Amended Final Judgment incorporating its determinations.

From this judgment, the United States now appeals, and the trustee cross-appeals.

*Analysis*

[1] The touchstone of this appeal is the applicability of Section 502(d) to this fact pattern. We find that Section 502(d) was not intended to have a punitive effect and consequently does not apply in this case. The bankruptcy arena requires a careful analysis and distinction between punishing a debtor for not paying and affording a weary creditor the right to setoff.

I. Section 553(a)-Setoff

The right to setoff is found in Section 553(a) of the Bankruptcy Code, which provides that:

> [the Bankruptcy Code] does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under the title against a claim of such creditor against the debtor that arose before the commencement of the case . . . .

This right of setoff found in the current Bankruptcy Code was also found in the Bankruptcy Act of 1898.4/ The policy of Section 553(a) is to prevent the "possible injustice in requiring a creditor to file its claim for satisfaction in the bankruptcy court, while at the same time compelling the same creditor

4/ 11 U.S.C. § 108(a) (1971).

to pay in full its debt to the bankruptcy estate." *In re Southern Indus. Banking Corp.*, 809 F.2d 329, 332 (6th Cir. 1987). See also *In re G.S. Omni Corp.*, 835 F.2d 1317, 1318 (10th Cir. 1987).5/ Given the expressed policy, the extent or application of this policy is not clearly defined. In this scenario, the IRS' right to setoff derives from Section 6402(a) of the Internal Revenue Code of 1986, which provides that generally a party is only entitled to a tax refund of the amount

5/ The historical antecedent of the doctrine of setoff dates back to the Roman Empire and is based on the common sense notion that "a man should not be compelled to pay one moment what he will be entitled to recover back the next." Lloyd, The Development of Setoff, 64 U.Pa.L.Rev. 541, 541 (1916). See *N.Y. County Bank v. Massey*, 192 U.S. 138, 146, 24 S.Ct. 199, 201, 48 L.Ed. 380 (1904). The doctrine was incorporated into the English bankruptcy scheme in 1705 and became part of the American bankruptcy scheme with the passage of the Act of 1800. See *Bohack Corp. v. Borden, Inc.*, 599 F.2d 1160, 1164 (2d Cir. 1979); 3 *Collier on Bankruptcy*, para. 553.01 (1988 ed.).

which exceeds any outstanding tax liabilities. *Kabbaby v. Richardson*, 520 F.2d 334 (5th Cir. 1975); *U.S. v. Rochelle*, 363 F.2d 225 (5th Cir. 1966).

The issue at hand is whether the IRS must refund the amount owed or be able to wait until the final determination in the San Antonio litigation. The district court held that the United States had unduly delayed the turnover of the refunds and consequently disallowed the government's other tax claims in the subsequent litigation. The appeal in the San Antonio litigation was resolved on March 10, 1988, and the hearing held and issues determined on March 15, 1988, which gave the IRS a net of five days to turn over the money. The district court dismissed the additional claims by asserting that five days was more than a reasonable time and thus Section 502(d) applied. The district

court erred in using Section 502(d) to have this punitive effect.

The legislative history and policy behind Section 502(d) illustrates that the section is intended to have the coercive effect of insuring compliance with judicial orders. In this case, there is no showing of the IRS' lack of compliance, only the exercising of their right to appeal and delay payment to insure their ability to exercise their right to setoff. The IRS asserts that it stood ready, willing, and able to comply with the district court's turnover order when the San Antonio litigation was finalized.

Granted, Section 502(d) should be used when something more than a gentle influence is needed, but penalization for appealing liability when the debtor stood ready, willing and able is not the proper application of Section 502(d). This section is designed to be triggered after

a creditor has been afforded a reasonable time in which to turn over amounts adjudicated to belong to the bankruptcy estate.6/ We find that the five days which had elapsed since the final determination of the San Antonio litigation until the district court's dismissal did not afford the IRS a reasonable time.

[2] Section 502(d) is designed to assure an equality of distribution of the assets of the bankruptcy estate not create penalties for asserting a setoff right. Bankruptcy is the area most likely to require a right to postpone payment until final adjudication of liability, otherwise the right to setoff would be worthy of little more than the book in which it is found. *Katchen v. Landy*, 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966).

6/ *Keppel v. Tiffin Savings Bank*, 197 U.S. 356, 361, 25 S.Ct. 443, 444, 49 L.Ed. 790 (1905).

[3] The merits of the appeal is a legal issue but not proper in this dispute. A penalization for a meritless appeal can be accomplished, but not by using Section 502(d). The creditor is still entitled to a reasonable time after the final determination under Section 502(d) is kicked into effect. Thus, a court may not order a turnover in one instant and in the same instant disallow a creditor's claim for failing to comply with that order. Courts applying Section 502(d) have done so by affording the creditor a reasonable period of time before dismissing claims.7/ The district court in this case erred in not affording the IRS a reasonable period of time after

7/ See, *e.g., In re W & T Enterprises, Inc.*, 84 B.R. 838, 840 (Bkrtcy. M.D. Fla. 1988); *In re Air One, Inc.*, 80 B.R. 145, 148 (Bkrtcy. E.D. Mo. 1987); *In the Matter of Mid-Atlantic Fund, Inc.*, 60 B.R. 604, 604 (Bkrtcy. S.D.N.Y. 1986); *In re Bob Grissett Golf Shoppes, Inc.*, 50 B.R. 598, 607 (Bkrtcy. E.D. Va. 1985).

the resolution of the San Antonio litigation.

An equitable analysis of this scenario yields the same result of affording the IRS a reasonable time after the entry of the order. Equity certainly cannot be used to impose a penalty when Congress did not intend one. In this case, the distinction between coercion and penalization is an important one.

II. Attorneys fees

[4] The District Court's award of attorneys fees must fail as a result of the interpretation of Section 502(d). The only legal basis for that award is Section 7430 of the Internal Revenue Code of 1986. Under Section 7430, the appellee would only be entitled to recovery if classified as the prevailing party, which has two components. First, the appellee must establish that the position of the United

States in the civil proceeding was unreasonable; and second, the appellee must have either substantially prevailed with respect to the amount in controversy or substantially prevailed with respect to the most significant issue or set of issues presented.[8/]

Due to the reversal of the applicability of Section 502(d), the trustee is no longer the "prevailing party," because the IRS was not unreasonable in asserting their right to setoff nor in asserting that a reasonable time was something more than five days. Further, the party who substantially prevailed is yet to be determined, given the reinstatement of the IRS' dismissed claims. Consequently, the award of

[8/] See, generally, H.R. Rep. No. 97-404, 97th Cong. 1st Sess. at 10-16 (1981); Senate Committee on Finance, "Technical Explanation of Committee," 127 Cong. Rec. S15587, S15593-S15595 (daily ed. Dec. 16, 1981).

attorneys fees entered by the district court must be reversed. See *Huckaby v. U.S. Dept. of Treasury*, 804 F.2d 297 (5th Cir. 1986).

*Conclusion*

[5] We find the legislative history and purpose behind Section 502(d) to be assuring the bankruptcy estate that a creditor will not be allowed to assert a claim without first paying his own debts, but not to be ready to penalize a wary debtor before the expiration of a reasonable time after final determination of liability. As a result of the decision regarding the IRS' claims being reversed, the attorneys fees award, which is attached to the trustee being the prevailing party is also reversed. Accordingly, the District Court is REVERSED on both the applicability of Section 502(d) and the award of attorneys fees. This case is REMANDED to the

district court to reinstate the dismissed claims of penalties and interest. After proper determination of final liability, the district court shall render a corresponding judgment, allowing the reinstated claims of penalties and interest to be offset against the liabilities already litigated, and attorneys fees if found appropriate.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| In Re: | § | |
| | § | |
| EDWARD MIKE DAVIS d/b/a TIGER OIL COMPANY, | § | CASE NO. 80-00940-HB (Chapter 11) |
| | § | |
| Debtor. | § | |
| | § | |
| In Re: | § | |
| | § | CASE NO. 80-00940-HB |
| TIGER DRILLING COMPANY, INC., | § | (Chapter 11) |
| | § | |
| Debtor. | § | |
| | § | |
| RHETT G. CAMPBELL, Trustee, | § | |
| | § | |
| Plaintiff, | § | |
| | § | |
| vs. | § | ADVERSARY NO. 84-0525-H1 |
| | § | |
| UNITED STATES OF AMERICA, | § | |
| | § | |
| Defendant. | § | |

AMENDED FINAL JUDGMENT

It is adjudged that Rhett G. Campbell, Trustee of the Tiger Oil Company and Tiger Drilling Co. Creditors Trust, recover from the Internal Revenue Service:

1. $1,397,568.00 principal and pre-judgment interest;

2. $15,000.00 attorney's fees; and

3. Post-judgment interest at 6.71% per annum.

Signed on March 25, 1988 at Houston, Texas.

/s/
Lynn N. Hughes
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| In Re: | § | |
| | § | |
| EDWARD MIKE DAVIS d/b/a TIGER OIL COMPANY, | § | CASE NO. 80-00940-HB (Chapter 11) |
| | § | |
| Debtor. | § | |
| | § | |
| In Re: | § | |
| | § | CASE NO. 80-00940-HB |
| TIGER DRILLING COMPANY, INC., | § | (Chapter 11) |
| | § | |
| Debtor. | § | |
| | § | |
| RHETT G. CAMPBELL, Trustee, | § | |
| | § | |
| Plaintiff, | § | |
| | § | |
| vs. | § | ADVERSARY NO. 84-0525-H1 |
| | § | |
| UNITED STATES OF AMERICA, | § | |
| | § | |
| Defendant. | § | |

FINAL JUDGMENT

It is adjudged that the Estate of Tiger Drilling Co., Inc., recover from the Internal Revenue Service:

1. $1,397,568.00 principal and pre-judgment interest;

2. $15,000.00 attorney's fees; and

3. Post-judgment interest at 6.71% per annum.

Signed on March 18, 1988, at Houston, Texas.

/s/
Lynn N. Hughes
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| IN RE: | § | |
| | § | |
| EDWARD MIKE DAVIS d/b/a TIGER OIL COMPANY, | § | CA H-88-1901 |
| | § | |
| | § | CASE NO. 80-00940-HB |
| | § | (Chapter 11) |
| Debtor. | § | |
| | § | |
| | § | |
| In Re: | § | |
| | § | CASE NO. 80-00940-HB |
| TIGER DRILLING COMPANY, INC., | § | (Chapter 11) |
| | § | |
| Debtor. | § | |
| | § | |
| | § | |
| RHETT G. CAMPBELL, TRUSTEE, | § | |
| | § | |
| | § | |
| PLAINTIFF, | § | |
| V. | § | ADVERSARY NO. 84-0525-H1 |
| | § | MARCH 15, 1988 |
| UNITED STATES OF AMERICA, | § | 2:00 P.M. |
| | § | |
| | § | |
| DEFENDANT. | § | |
| | § | |

BEFORE THE HONORABLE LYNN N. HUGHES, JUDGE,
UNITED STATES DISTRICT COURT,
SOUTHERN DISTRICT.

(APPEARANCES ON PAGE 2)

THE COURT REPORTER: MS. SUZANNE FORET
515 RUSK
HOUSTON, TEXAS 77002

PROCEEDINGS RECORDED BY STENOGRAPHY; TRANSCRIPT PRODUCED BY DICTATION.

APPEARANCES:

FOR THE PLAINTIFF: MR. JOHN R. KNIGHT
MR. RHETT G. CAMPBELL
MORRIS & CAMPBELL
600 JEFFERSON STREET,
#1617
HOUSTON, TEXAS 77002

FOR THE DEFENDANT: MR. JOSEPH PITZINGER, III
ATTORNEY, TAX DIVISION
DEPARTMENT OF JUSTICE
ROOM 5B31, 1100 COMMERCE
DALLAS, TEXAS 75242-0599

(Excerpt from the transcript of proceedings, pages 74-81, setting forth the district court's oral Findings of Fact and Conclusions of Law.)

(A TEN-MINUTE BREAK WAS TAKEN)

THE COURT: BE SEATED. FRANKLY, THE COURT HAS SOME DIFFICULTY WITH THE GOVERNMENT'S POSITION THAT IT CAN WITHHOLD THIS MONEY AND THEN GO BACK AND OFFSET THINGS IT MAY OR MAY NOT HAVE ACCRUED OVER A TWELVE-YEAR PERIOD. AFTER ALL, HAVING A HALF A MILLION DOLLARS IN 1974 MAY HAVE BEEN OF CONSIDERABLE ASSISTANCE TO THE DEBTOR IN WORKING OUT HIS PROBLEMS, AND THAT MONEY, DESPITE THE BONA FIDE DISPUTE ABOUT THE OTHER FIVE AND HALF MILLION DOLLARS, I THINK, SHOULD HAVE BEEN PAID.

THE COURT ACCEPTS MS. HANSEN'S METHOD OF CALCULATING WHAT THE INTEREST AND PRINCIPAL WOULD BE IF IT WERE DONE RELATIVELY CONTEMPORANEOUSLY WITH THE EVENTS GIVING RISE TO THE REFUNDS AND OFFSETS.

HOWEVER, THE COURT FINDS THAT MR. WINKLER'S CALCULATION OF THE $738,396 OF PRINCIPAL REFUNDS PLUS THE ACCRUED

INTEREST OF $1,162,801 OUGHT TO BE PAID TO THE ESTATE LESS ONLY THE PRINCIPLE AMOUNT OF THE ACTUAL TAXES THAT TURNED OUT TO BE DUE WHICH, FOR THE SAKE OF KEEPING ALL OF OUR SANITIES, THE COURT WILL ACCEPT THAT $390,000, LEAVING A REFUND DUE THE ESTATE OF $1,511,197.

CAN YOU ALL AGREE ON HOW MUCH OF THAT IS PRINCIPAL AND HOW MUCH OF THAT IS INTEREST, OR DO I NEED TO TELL YOU?

MR. PITZINGER: I COULDN'T HEAR THE FIGURES, YOUR HONOR.

THE COURT: WELL, IT'S $390,000 LESS THE $1,901,197. IT SHOULD BE $1,511,197. IN ORDER TO SPEEDILY TERMINATE THE LITIGATION IN LIEU OF THE EQUITABLE NATURE, THE ULTIMATE RESOLUTION OF THIS, I THINK I WILL GO AHEAD AND DECIDE THE ATTORNEY'S FEES AND ISSUE $15,000, BEING A BELOW-MARKET RATE. THERE'S NO REFLECTION ON MR. CAMPBELL ANY MORE THAN THE BELOW-NET RECOVERY IS A REFLECTION ON MS.

HANSEN. IT'S A MESS OF NEITHER OR THEIR MAKING.

IT BECOMES MORE INEQUITABLE WHEN THE BENEFICIARIES OF THE REFUND ARE NO LONGER THE TAXPAYER, BUT A GROUP OF UNPAID CREDITORS.

MR. KNIGHT, ARE THERE ANY OTHER FINDINGS YOU THINK I SHOULD MAKE IN ORDER TO COMPLETE YOUR RECORD?

MR. KNIGHT: NO, YOUR HONOR.

THE COURT: MR. PITZINGER, ARE THERE ANY FINDINGS YOU THINK ARE FAIRLY RAISED BY THE EVIDENCE YOU WOULD LIKE ME TO MAKE TO COMPLETE THE RECORD THAT DON'T CONTRADICT THE OBVIOUS THRUST OF MY DECISION?

MR. PITZINGER: NOT AT THIS TIME, YOUR HONOR. ARE YOU GOING TO WRITE AN OPINION, YOUR HONOR?

THE COURT: I'M GOING TO ANNOUNCE MY FINDINGS NOW. ESSENTIALLY WE'VE GOT -- MS. HANSEN'S CALCULATIONS ARE WHAT SHOULD

HAVE BEEN DONE FROM THE BEGINNING. MR. WINKLER'S CALCULATIONS ARE WHAT WOULD HAVE BEEN DONE IF I TOOK THE HARD-LINE VIEW THAT MR. KNIGHT URGED. BUT SINCE THEY PRAYED FOR THE NET BALANCE, I THINK THEY ONLY OUGHT TO GET THE BALANCE. BUT I DON'T THINK YOU OUGHT TO BE ABLE TO COLLECT OFFSETTING PENALTIES AND INTEREST IN THE INTERIM. SO I'M GIVING THEM THE INTEREST AND TODAY SUBTRACTING WHAT IT TURNS OUT THEY OWED.

MR. PITZINGER: YOUR HONOR, I THINK WE NEED SOME FINDINGS OF FACT ON WHAT YOU CONSIDER TO BE THE PRINCIPLE AMOUNT THEY PRAYED FOR AND HOW THE I.R.S. IS TAKING OFF SOME INTERIM TAX AND PENALTIES. PERHAPS I JUST DON'T UNDERSTAND.

THE COURT: WELL, WHAT I DID WAS I TOOK THE REFUND AMOUNTS THAT WERE DUE AND ADDED THEM UP, $738,396. THEN INTEREST ON THOSE AMOUNTS AS THEY BECAME DUE AT THE PUBLISHED INTERNAL REVENUE SERVICE

INTEREST RATE IS $1,162,801, FOR A TOTAL DUE THE ESTATE OF THE TAXPAYER OF $1,901,197.

NOW, TODAY -- AND NOT AS THE TAXPAYER PROGRESSED FOR THE LAST TWELVE YEARS, BUT TODAY -- THE I.R.S. HAS SHOWED THAT THERE WAS ANOTHER $390,000 OF TAXES WHICH WERE APPARENTLY DUE ON VARIOUS OCCASIONS IN THE PAST. BUT I'M NOT GOING TO ALLOW YOU TO SET THOSE OFF AGAINST THE TAXES DUE WHEN THEY ACCRUED BECAUSE THE TAXPAYER IS ENTITLED TO KNOW WHAT IS BEING DONE TO THEM, AND UNTIL TODAY IT WAS IMPOSSIBLE TO FIND OUT. SO I'M SUBTRACTING $390,000 OF CUMULATIVE FURTHER TAXES TODAY, AND THAT MAKES IT --

MR. PITZINGER: IS THAT IMPLYING, YOUR HONOR, THAT THE I.R.S. DID NOT FILE THEIR PROOFS OF CLAIM?

THE COURT: NO. I AM ACCEPTING THE SUBSIDIARY TAX FACTS IN YOUR PROPOSED FINDINGS AS AMENDED BY THE REPRESENTATIONS

HERE. BUT THAT IS OMITTING ALL INTEREST AS WELL AS THE PENALTIES.

MR. PITZINGER: I'M CONCERNED, I GUESS, ALSO, YOUR HONOR, ABOUT THE FINDING OF FACT THAT THEY'VE HAD THE MONEY AVAILABLE FOR TWELVE YEARS, YOUR HONOR. TO THE BEST OF MY KNOWLEDGE, THE PETITION DATE WAS IN 1980, AND THE MONEY, IF IT WAS AVAILABLE, WAS NOT UNTIL AFTER THE PETITION DATE.

THE COURT: THE MONEY -- THE OVERPAYMENT WAS APPARENTLY DUE IN 1-'76.

MR. PITZINGER: YES, YOUR HONOR, DUE TO THE CARRY-BACK OF THE NET OPERATING LOSS FOR 1975, WHICH WAS DETERMINED BACK IN 1979-1980.

THE COURT: THEY WOULD HAVE BEEN GIVEN -- IF YOU PAID THEM IN '80, YOU WOULD HAVE GIVEN THEM TAX FOR THE EARLIER TWO YEARS. THAT'S WHAT SHE SAID.

MS. HANSEN: OWED THEM INTEREST FROM THEN.

MR. PITZINGER: YES, YOUR HONOR, BUT IT WAS NOT AVAILABLE DURING THE PERIOD FROM 1976 TO 1981. IT WASN'T ACTUALLY AVAILABLE UNTIL THE PROOFS OF CLAIM WERE FILED AND AFTER THE AUDIT -- IT WAS AN AUDIT ADJUSTMENT IN 1981.

THE COURT: BUT YOU STILL WOULD HAVE -- INTEREST WOULD HAVE BEEN ACCRUING.

MR. PITZINGER: IT ACCRUES AFTER THE FACT. ONCE SOMEBODY FILES A RETURN, ASSUMING THEY WERE ENTITLED TO A REFUND MANY YEARS AGO, THE I.R.S. DOES PAY INTEREST UP UNTIL -- STARTING ON A CERTAIN DATE.

THE COURT: BUT YOU DON'T FILE A PROOF OF CLAIM ON WHAT YOU OWE THEM. THAT'S AN ASSET OF THE ESTATE. YOU FILE A PROOF OF CLAIM ON WHAT YOU SAY THEY OWE YOU. YOU HAD NO OCCASION TO DEMAND PAYMENT WHEN THE TRUTH WAS YOU OWED THEM. YOU SHOULD HAVE BEEN SCHEDULED AS A CREDITOR AND NOT AS A DEBTOR.

MR. PITZINGER: WELL, YOUR HONOR, I KNOW THERE'S A CONFLICT HERE IN YOUR SCHEDULE. HOWEVER, I THINK THE IMPORTANT THING WAS --

THE COURT: I TOOK YOUR TESTIMONY OF WHAT THE AGGREGATE TAXES THAT HAD ACCRUED DURING THE PERIOD WITHOUT INTEREST OR PENALTY. I DON'T THINK YOU COULD EARN INTEREST AND PENALTY ON TAXES THAT YOU CAN'T TELL THEM ABOUT, WHICH SEEMS A LOT LESS HARSH THAN OFFSETTING -- WIPING OUT THE WHOLE BATCH OF IT BECAUSE YOU WERE GIVEN THIS MONEY -- ALL I'M DOING IS ELIMINATING YOUR PENALTIES AND INTEREST BECAUSE OF THE INTERNAL REVENUE SERVICE INTRANSIGENCE OVER LOSING THE CASE IN SAN ANTONIO, AS THEY WOULD CHARACTERIZE IT. I MIGHT NOT BE THAT HARSH.

YOU LOST THE CASE IN SAN ANTONIO. YOU TIED UP THEIR HALF A MILLION DOLLARS FOR AN EXTRA SIX OR EIGHT YEARS, OR FOR FOUR YEARS OR HOWEVER LONG IT WAS.

MR. PITZINGER: YES, YOUR HONOR. DO YOU HAVE ANY FINDING CONCERNING THEN THE ORDER CONFIRMING THE PLAN AND CONCERNING STATEMENTS ON HOW THE ORDER CONFIRMING THE PLAN DOES OR DOES NOT MAKE THE MONEY UNAVAILABLE OR OF INSUFFICIENT VALUE TO THE INTERNAL REVENUE SERVICE -- OR TO THE DEBTOR. I'M SORRY.

THE COURT: BUT YOUR SECURITY - THE INSECURITY PROBLEM ONLY AROSE WITH RESPECT TO THE FIVE AND A HALF MILLION DOLLAR CASE THAT THE I.R.S. LOST. HOW COULD YOU BE INSECURE WHEN YOU OWE THEM MONEY? THE I.R.S. WAS THE DEBTOR. CREDITORS ARE THE PEOPLE WHO GET TO BE INSECURE. DID I MISS SOMETHING? MAYBE I OUGHT TO REPHRASE THAT. IS THERE SOMETHING YOU WOULD LIKE TO ADD?

MR. PITZINGER: NO, YOUR HONOR.

THE COURT: I THINK THE ORDER SIMPLY PROHIBITED THE TRUSTEE FROM MAKING DISBURSEMENTS UNTIL THEY GOT THE PENDING

LITIGATION. SO THAT'S THE ONLY THING I SAW IN THE CONFIRMATION ORDER WAS THAT THEY'RE NOT SUPPOSED TO SPEND THE MONEY UNTIL THEY'VE GOT THE PENDING LIABILITIES LIQUIDATED.

MR. PITZINGER: YOUR HONOR, THEN THE UNITED STATES WOULD LIKE A FINDING CONCERNING THE FACT THAT IT HAS IN THIS LAWSUIT REPRESENTED IT IS READY TO REFUND THE AMOUNT. I'LL ADMIT THE AMOUNT WE'VE COME UP WITH --

THE COURT: THERE'S NO QUESTION THAT YOU ALL HAVE BEEN WILLING SINCE SOMETIME THIS MORNING TO RETURN $405,551.84. NONE OF THIS REFLECTS ON YOU ALL. IT JUST -- I DON'T THINK IT'S EQUITABLE FOR THEM TO KEEP A HALF A MILLION DOLLARS AND THEN SOMEWHERE LATER AFTER ALL THESE YEARS HAVE GONE BY -- WHETHER IT'S EIGHT OR TWELVE -- AT THE MINIMUS, EIGHT YEARS IS A LONG TIME NOT TO GET YOUR MONEY.

LIKE I SAY, I THINK MS. HANSEN'S CALCULATIONS ARE CORRECT OF WHAT SHOULD HAVE HAPPENED BETWEEN THE PARTIES.

MR. PITZINGER: ANOTHER FINDING, YOUR HONOR, IS CONCERNING THE FACT THAT IT'S BEEN THE POSITION OF THE UNITED STATES THAT FROM THE PERIOD ENDING 5/31/81 WHERE MR. WINKLER HAS USED THAT FIGURE OF $113,629, IT'S BEEN THE POSITION OF THE I.R.S. THAT WAS ALREADY REDUCING THE TAX DUE TO THE UNITED STATES.

THE COURT: I'M SORRY. I THOUGHT I CORRECTED THAT ADJUSTMENT ON BOTH NUMBERS, DID I NOT?

MS. HANSEN: NO. THAT NEEDS TO BE ADDED TO THE $390,000, IF YOU'RE GOING TO ALLOW IT HERE.

THE COURT: YEAH. I ADDED IT -- DID I NOT ADD IT TO THE PRINCIPAL?

MS. HANSEN: YOU DIDN'T ADD IT TO THE PRINCIPAL.

MR. PITZINGER: HER TESTIMONY CONCERNING THE $390,000 IS NOT THE SAME AS THE $113,000, YOUR HONOR.

THE COURT: THAT'S RIGHT. HE HAS GOT THE HUNDRED THIRTEEN ON HIS SCHEDULE. SO INSTEAD OF THE $390,000 IN TAX DUE, IT'S $503,629?

MS. HANSEN: YES.

THE COURT: I'M SORRY. WITH THAT CORRECTION, ARE THERE ANY OTHER --

MR. PITZINGER: NO, YOUR HONOR.

MR. KNIGHT: NO, YOUR HONOR.

THE COURT: I ONLY WISH THEY WOULD CONFIRM JUDGE HOYT IN TIME FOR ME TO GIVE THIS TO HIM. OTHER THAN THAT, YOU ALL MAY BE EXCUSED. THANK YOU.

(THIS CONCLUDES THE HEARING PROCEEDINGS.)

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

---

No. 88-2555

---

D.C. Docket No. CA-H-88-1901

In The Matter of: Edward Mike Davis d/b/a Tiger Oil Company, and Tiger Drilling Company, Inc., Debtors.

RHETT G. CAMPBELL, TRUSTEE,

Appellee
Cross-Appellant,

versus

UNITED STATES OF AMERICA,

Appellant
Cross-Appellee.

Appeals from the United States District Court for the Southern District of Texas

Before GARZA, REAVLEY, and POLITZ, Circuit Judges.

J U D G M E N T

This cause came on to be heard on the record on appeal and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court

that the judgment of the District Court in this cause is reversed, and the cause is remanded to the District Court for further proceedings in accordance with the opinion of this Court.

IT IS FURTHER ORDERED that each party bear its own costs on appeal.

December 8, 1989

ISSUED AS MANDATE: JAN 22 1990

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

---

No. 88-2555

---

In The Matter of: Edward Mike Davis d/b/a
Tiger Oil Company, and
Tiger Drilling Company,
Inc.,

Debtors.

RHETT G. CAMPBELL, TRUSTEE,

Appellee
Cross-Appellant,

V.

UNITED STATES OF AMERICA,

Appellant
Cross-Appellee.

---

Appeal from the United States District
Court for the Southern District of Texas

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ON PETITION FOR REHEARING

( January 10, 1990 )

Before GARZA, REAVLEY and POLITZ, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

ENTERED FOR THE COURT:

/s/ Thomas M. Reavley
United States Circuit Judge